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Statement by
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Deputy Inspector General
Department of Defense
Before the
Committee on Governmental Affairs
United States Senate
on
Defense Financial Management Progress

Mr. Chairman and Members of the Committee:

I am pleased to be here this morning to discuss financial management in the Department of Defense. I am accompanied by Mr. Robert Lieberman, the Assistant Inspector General for Auditing.

The Problems

For approximately four years, dozens of reports from my office, the GAO, Military Department auditors, congressional committees and the press have revealed a wide range of DoD financial management problems. Some are easy to describe--duplicate and overpayments to contractors, payments to soldiers no longer in the Army, spending more than was appropriated, and keeping inaccurate records. Others are more complicated--not matching disbursements to obligations or not maintaining fund integrity during the disbursement process.

Some of the problems, such as the unmanageable situation created by having 161 different accounting systems, have been obvious for years. In fact, the creation of the Defense Finance and Accounting Service and the Corporate Information Management initiative was driven by the Department's realization that drastic reform measures were necessary. Other problems were known within the DoD financial management community, but remained largely invisible to top DoD officials and the Congress until the

Department made its first attempts to construct auditable annual financial statements. The Comptroller General, the Auditor General of the Air Force, and the Office of the Inspector General described many of those problems to the Committee during the hearing on July 1, 1993. We pointed out widespread internal control weaknesses, failure to reconcile conflicting data or maintain audit trails, significant instances of failure to comply with laws and regulations ranging from the Prompt Payment Act to the Chief Financial Officers Act, the lack of standard data elements for financial systems or a standard general ledger, and the limited use of the DoD chart of accounts. We noted that only two of the sixteen 1992 financial statements audited by our staff received relatively clean opinions and the results of the other audit organizations' work were similar.

Audit Coverage of Financial Matters

In accordance with the CFO Act, another series of financial statement audits is under way. This is necessarily another huge effort, because financial statement audits are very labor intensive when large, complicated funds and voluminous, scattered and conflicting records are involved. Despite budgeted cuts in audit resources and high demand for coverage in other program areas, the DoD internal audit community plans to commit about 500 work years and over \$40 million annually to CFO reviews in FY 1994 and FY 1995. For the last two years and for the foreseeable future, implementing the CFO Act involves the largest commitment

of auditors ever to a single purpose. In addition, my office will continue the expanded operations audit coverage of financial and accounting matters that we began after the creation of the Defense Finance and Accounting Service. The result will be a continued steady flow of audit quality information to DoD managers and Congress. Examples of recent audit reports are summarized in the attachment to this statement. The financial statement audit reports on FY 1993 statements will not begin flowing, in final form at least, for several more weeks and most will be issued in June.

On the one hand, increased audit emphasis will ensure that the financial management problem areas are fully identified and the effect of corrective actions is closely monitored. On the other hand, the flow of reports on DoD financial management will strike many people as a drumbeat of criticism meaning that the problems are new or getting worse. In fact, in most cases, the financial management problems facing the DoD today have been festering for many years and blame for the proliferation of inefficient systems is shared by scores of officials over decades. In retrospect, it is unfortunate that the CFO Act and the revisions to the use of "M" accounts did not come into being long ago to focus DoD and congressional attention on this vital aspect of the Department's operations. It also should be candidly stated that the procedures requiring General Accounting Office certification of DoD accounting systems, the Federal Managers' Financial Integrity Act, the Antideficiency Act,

numerous Federal and DoD financial management improvement programs, and millions of dollars spent on financial systems all failed to keep the kinds of problems now being highlighted from developing. Likewise, in hindsight there was clearly insufficient and poorly focused audit coverage.

The Causes

The Department must now face the music and live with the results of numerous previous bad decisions and poor management practices. Allowing the proliferation of incompatible, parochial systems and nonstandard data elements has been mentioned. Other prominent causes for current financial problems include the wave of fixed price weapons development contracts in the early and mid-1980's. That ill-fated experiment gave rise to a long list of troubled acquisition programs whose escape valve--the merged surplus accounts--was rightfully closed by the Congress because of an additional series of miscalculations in the form of inappropriate uses of those "M" accounts by the Air Force.

When an agency faces painful downsizing decisions and has numerous financially strapped programs, it urgently needs responsive, accurate and reliable data on costs and fund availability. Unfortunately, it is precisely at this critical juncture for National Defense that the DoD and Congress have both recognized the serious shortcomings of DoD fiscal systems, records and reports. As the new DoD Comptroller is fond of

saying, we need to change a tire while going 60 miles per hour and there is no way to stop to do it, because funds need to keep flowing to tens of thousands of suppliers and millions of active and retired military members and civilian employees. At the same time, it would be a mistake to give in to gloom and doom. While the difficulties in fixing huge problems like the poor interface of DoD contract management and accounting systems should not be underestimated, I am dubious about claims that corrective action needs to take many years if the will exists to take on those problems once and for all.

What Needs to be Done

The crucial question, as we see it, is what can be done to ensure the DoD truly gets on top of its financial management problems and regains credibility that it can keep its books accurately. We believe the following things are crucial:

-- Top management involvement. So far, the new DoD Senior Financial Management Oversight Council looks promising as a way to involve the most senior OSD and Military Department officials in systemic financial management issues. In previous years, those officials would have left problems like undistributed disbursements to the comptroller community to worry about in isolation, while also defending the need for unique accounting, finance and acquisition management systems in each Service.

As far as financial management was concerned, top managers tended to focus primarily on budgets and resource allocation decisions, not on accounting systems, execution, and program results. The historic pattern will continue unless there is leadership from the Office of the Secretary of Defense. The operations of the Senior Financial Management Oversight Council are demonstrating that such leadership is being provided and we certainly endorse its continuance. It is especially important that the Council follow up on all of the measures it directs, requiring meaningful progress reports and taking decisive action when progress lags.

-- Congressional interest. Periodic hearings are important to demonstrate congressional interest and to provide a forum for discussion of DoD progress. Your Committee's leadership has been very helpful in this regard. Improving DoD financial management is an area where Executive Branch and congressional interests match very closely. There is clearly a consensus that the time has come for constructive change.

-- Restoration of Antideficiency Act credibility. The Senior Financial Management Council has directed that measures be taken to improve the process for investigating apparent Antideficiency Act violations, promptly reporting results, and ensuring that more meaningful and consistent penalties are imposed when appropriate. My office is participating in the

development of a more structured and effective DoD process, which in turn should help create more credible deterrence. We have been especially pleased by the recent action of the DoD Comptroller to pull the function of monitoring violation investigation status out of the Defense Finance and Accounting Service into his immediate staff. Likewise, we strongly endorse the excellent guidance recently issued by Mr. Hamre regarding the need to cease further expenditures as soon as there are indications of deficient conditions in any account.

-- Close monitoring of automated system development efforts. All aspects of DoD finance and accounting operations necessarily are heavily computerized. Moving forward to standard, modernized systems is crucial if most of the problems are to be addressed effectively. The history of automated system development projects in the DoD, as in most of the Federal Government, is not an especially happy story. Development efforts generally take too long, cost too much, and do not result in systems that are fully satisfactory to the users. We simply must improve on that record. Frequent, meaningful progress assessments are needed. The GAO has considerable expertise in monitoring system development and I intend for my staff and the Military Department auditors to help as well. Besides monitoring progress in the system development area, there is a compelling need for audits of controls in existing systems that the Department will continue to depend on. As shown in the attached summaries, we have begun tackling that workload.

-- Reexamination of budget and accounting data requirements. Congress could consider ways to help DoD simplify and streamline its account structure and financial management process. Two year budgets, longer periods of appropriation availability for obligations, fewer appropriations or less restrictions on specific line items, and elimination of unnecessary budget exhibits and reports are all possibilities.

-- Improvement of Defense Business Operations Fund (DBOF) management. The DBOF is a bold attempt by the DoD to drive down long term costs. We support the DBOF concept and believe that the ongoing improvement plan directed by the DBOF Corporate Board is comprehensive and promising. That being said, it is true that the DBOF will yield very few if any benefits until (1) DoD cost accounting and DBOF rate setting improve and (2) more alternative sources of goods and services are opened to current DBOF customers. It is also imperative that DoD solve the cash management problems that plagued DBOF and aroused understandable congressional ire over the past couple years. In general, we agree with the GAO assessment that progress is being made, especially now that the fundamental problem of the lack of specific, written DBOF management policies has finally been addressed.

In closing, we believe that the DoD has made a credible start in solving its numerous, deeply rooted financial system

problems. By the same token, it is evident that much additional effort will be necessary. This concludes my statement and we would be happy to answer any questions.

RECENT SIGNIFICANT INSPECTOR GENERAL, DOD, AUDIT REPORTS

FUNDING SHORTFALLS AND ERRORS IN NAVY ACCOUNTS

Report No. 94-036, "Financial Status of Navy Expired Year Appropriations," February 10, 1994. The audit reported potential Antideficiency Act violations in the MK-50 Torpedo and Standard Missile programs and potential funding deficiencies in the Trident II and Phoenix Missile programs, all of which are funded in the Navy Weapons Procurement appropriation. Also, potential deficiencies were found in the Navy Aircraft Procurement and Research, Development, Test and Evaluation appropriations. The official accounting records did not reflect the true appropriations balances, and the Navy had \$1 billion in net unmatched disbursements. We recommended that the Assistant Secretary of the Navy (Financial Management) investigate apparent appropriation account deficiencies for the MK-50, the Standard Missile, and the Phoenix Missile, fix responsibility, and report any actual Antideficiency Act violations; record obligations even if they may cause deficiencies; establish procedures for identifying requirements that may cause deficiencies in the future; maintain contingent liabilities in accounting records after funds expire; and properly record obligations supporting contingent liabilities. The report also recommended that the Navy correct obligational adjustments, post them to the correct fiscal year, and establish procedures to verify that administering offices obtain proper approvals for obligational adjustments within established thresholds. Further, the report recommended that the Director, Defense Finance and Accounting Service establish automated procedures for ensuring that correct funding information is entered into the Standard Accounting and Reporting System. Management concurred with all recommendations in the draft report except that the Navy Director of Budget and Reports did not concur with our recommendations to maintain contingent liabilities in accounting records after funds expire and to correct accounting entries to show the proper charges for contract modifications. Further comments were requested.

FUNDING SHORTFALLS AND ERRORS IN AIR FORCE ACCOUNTS

Report No. 94-062, "Financial Status of Air Force Expired Year Appropriations," March 18, 1994. The expired year Air Force Research, Development, Test, and Evaluation (RDT&E)

Attachment

and Aircraft Procurement appropriations had shortfalls, accounting problems, and potential violations of the Antideficiency Act. Four of the eight expired appropriations were experiencing financial difficulty. The FY 1991 RDT&E and the FY 1989 Aircraft Procurement appropriations were potentially deficient by \$14.1 million and \$21.1 million, respectively. Both FY 1990 appropriations had very small available fund balances and were at high risk of being deficient in the near future. Uncorrected erroneous accounting entries for negative unliquidated obligations and progress payments totaled over \$1.8 billion and have the potential to further distort available fund balances. Also, DFAS-Denver did not track the use of \$208.6 million in current funds to finance obligation growth against former merged account unobligated balances and, contrary to DoD practice, permitted uncollected refunds totaling \$40.9 million to be used to finance obligation growth. Finally, \$432.2 million of refunds deemed to be uncollectible were not disclosed in Reports on Budget Execution and unclear DoD accounting practices for matters in litigation contributed to incorrect available fund balances. As a result, potential violations of the Antideficiency Act have occurred, and more may occur. We recommended that the Assistant Secretary of the Air Force (Financial Management) investigate the potential deficits in the FY 1991 RDT&E and FY 1989 Aircraft Procurement appropriations, fix responsibility, and report violations of the Antideficiency Act as appropriate. We also recommended that DFAS correct erroneous accounting conditions that caused material errors in Air Force fund accounting reports and institute adequate procedures to comply with fund limitations. We further recommended that the DoD Comptroller require the DFAS to implement DoD accounting practice for Air Force refunds receivable and amend the DoD Accounting Manual to specify how matters in litigation should be presented in fund control and accounting records. Comments have not yet been received.

WRONG DEBTS CANCELLED

Report No. 94-023 "Payment Errors Related to Operations Desert Shield and Desert Storm," December 23, 1993. The Conference Report that accompanied Public Law 102-172 requested that the IG, DoD, monitor the Defense Finance and Accounting Service's (DFAS) actions on canceling military member indebtedness related to Operations Desert Shield and Desert Storm. Numerous personnel had complained about aggressive efforts to collect debts that were often due to pay mistakes related to the rapid mobilization. The Congress gave the DoD authority to cancel debts up to

\$2,500. The audit concluded that 31 percent of 127,000 debts in one audit sample were inappropriate cancelled, and at one center \$15 million out of \$19.9 million in cancellations was unjustified. The DFAS Centers used specially-designed computer programs that did not follow the intent of Public Law 102-172 in identifying debts to be cancelled. Conversely, the computer programs did not identify many debts that were eligible for cancellation. Further, DFAS did not request an end to the debt cancellation program and Service members who continue to incur debts in connection with current Persian Gulf service could still have their debts canceled, which was not congressional intent. We recommended that DFAS correct significant unauthorized cancellations, identify and cancel additional eligible debts, and request an end to the debt cancellation program. The Director of DFAS nonconcurred and stated our recommendations for correcting the situation were too labor intensive and costly. Requisite records were not kept. To date no unauthorized cancellations have been recouped and the program remains in effect, although DFAS has agreed to end it. We will pursue the open matters through the DoD internal audit resolution process.

UNDISTRIBUTED AND UNMATCHED DISBURSEMENTS

Report No. 94-048, "Report on Uncleared Transactions By and For Others," March 2, 1994. Disbursing offices frequently make payments or collections involving funds belonging to other activities. This report discusses the need for more aggressive and effective DFAS actions to clear transactions timely and reduce undistributed and unmatched disbursements. Increased management oversight was needed to reduce net undistributed and unmatched disbursements valued at about \$34.6 billion as of January 31, 1993. The DFAS Centers took limited actions to research and resolve intra-Service disbursements that remained uncleared for extended periods, and actions taken were less than fully effective. Managers at DFAS Headquarters were not given complete and accurate information on the status of undistributed disbursements, including uncleared transactions. The DFAS Centers understated the numbers and dollar values of undistributed disbursements reported as more than 180 days old by about 860,000 transactions and at least \$7.2 billion. We recommended that the DoD Comptroller publish detailed guidance for clearing transactions and reducing undistributed disbursements. We recommend that DFAS improve procedures and controls over transactions that are not cleared promptly and issue specific policies for reporting undistributed disbursements. Management concurred with our

findings and recommendations and aggressive actions are now under way to reduce the DoD unmatched disbursement problems.

LOSS OF FUND INTEGRITY IN DISBURSEMENT PROCESS

Report No. 94-054, "Fund Control Over Contract Payments at the Defense Finance and Accounting Service - Columbus Center," March 15, 1994. The overall audit objective was to evaluate the adequacy of procedures used by DFAS-Columbus for fund control over contract payments. Procedures used by DFAS-Columbus to control appropriation fund data were not adequate. Specifically, obligation and disbursement data contained in the Mechanization of Contract Administration Services system were not accurate; and sampled contracts contained \$208.1 million in errors requiring accounting adjustments, \$10.4 million in additional disbursement errors, and \$741,000 in disbursements not charged to the proper appropriations. As of July 1993, contracts at DFAS-Columbus contained \$3.1 billion in negative unliquidated obligations at the Accounting Classification Reference Number level, and 2,659 contracts had negative balances totaling \$408.0 million. Further, up to 50 percent of the contracts and 70 percent of the modifications electronically transmitted to the Columbus Center through Military Standard Contract Administration Procedures (MILSCAP) were initially rejected or were incomplete when DFAS-Columbus received them, and had to be manually reentered. We recommended that the Director, DFAS, turn off the existing MILSCAP interface, complete necessary accounting adjustments, and correct errors for the contracts discussed in the report. The Director, DFAS agreed with the need for better supervisory and quality assurance reviews and other actions recommended. However, he did not concur with the need to terminate the current MILSCAP interface, and only partially concurred with two other recommendations. We will pursue these issues through the DoD audit resolution process.

SECURITY OF PAY SYSTEMS

Report No. 94-065, "Controls Over Operating System and Security Software Supporting the Defense Finance and Accounting Service," March 24, 1994. The audit objective was to determine whether management controls over selected features of the operating system and security software used on the production and test systems were adequate to safeguard the integrity of DFAS data. The audit concentrated on the operating system and security software used by four organizations to provide computer support to

the DFAS Centers in Kansas City, Missouri and Denver, Colorado. Those two DFAS Centers make about \$22.6 billion in annual payments on more than 390,000 payroll accounts. All four organizations had deficiencies in the implementation and control of operating system and security software. Any knowledgeable user could improperly access, add, modify, or destroy pay and accounting data, and enter erroneous data (accidentally or intentionally) without leaving an audit trail. The audit did not identify any unauthorized access to pay and accounting data. We recommended that DFAS, Defense Information Services Organization (DISO), and Marine Corps Computer and Telecommunications Activity (MCCTA) strengthen controls over the use of operating systems and security software and comply with established security requirements. DFAS and DISO concurred with the findings and recommendations. Comments have not yet been received from the Navy for the recommendations made to MCCTA.

DEFENSE BUSINESS OPERATIONS FUND ACCOUNTING

Report No. 94-082, "Financial Management of the Defense Business Operations Fund - FY 1992," April 11, 1994. Significant instances of weak internal controls relating to cash management and accounting systems existed. Also, transactions were not always executed in compliance with laws and regulations. Internal controls were not in place to ensure that cash transactions were verified and transactions made for or by others were recorded in a timely manner. Internal controls were not in place to ensure that \$17.7 billion in intrafund transactions were properly identified or eliminated. Audit trails were inadequate for substantive testing, a general lack of uniformity of accounting systems existed, and the U.S. Government Standard General Ledger had not been implemented. Additionally, recorded transactions were not supported with adequate documentation. Accounting systems used for the DBOF were not in compliance with requirements of Title 2 of the General Accounting Office's "Policies and Procedures Manual for Guidance of Federal Agencies." The DBOF financial statements were not prepared in full compliance with the Chief Financial Officers Act of 1990 as implemented by Office of Management and Budget Bulletin No. 93-02, "Form and Content of Agency Financial Statements," October 22, 1992. Reports to the Department of the Treasury required by the Debt Collection Act were inaccurate, and a system to monitor and report debts from contractors required by that act had not yet been implemented. A subaccount for recording and reporting \$1.1 billion in capital assets had not been established as required by the DoD Appropriations

Act. New activities were added to the DBOF in violation of the Defense Authorization Act for FYs 1992 and 1993. Real properties, which by law are under the jurisdiction of the Military Departments, were reflected as assets on the financial statements. The Defense Finance and Accounting Service generally agreed with our findings and recommendations. Comments on the draft report were not received from the Comptroller, DoD, and the final report requests a reply.